

REPORT ON EXAMINATION
OF THE
BERKLEY INSURANCE COMPANY
AS OF
DECEMBER 31, 2006

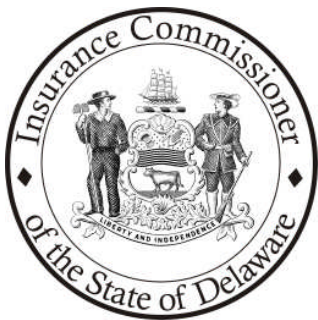
I, Matthew Denn, Insurance Commissioner of the State of Delaware, do hereby certify that the attached REPORT ON EXAMINATION, made as of DECEMBER 31, 2006 of the

BERKLEY INSURANCE COMPANY

is a true and correct copy of the document filed with this Department.

ATTEST BY: Antoinette Hardy

DATE: 18 JUNE 2008



In Witness Whereof, I HAVE HEREUNTO SET MY HAND AND AFFIXED THE OFFICIAL SEAL OF THIS DEPARTMENT AT THE CITY OF DOVER, THIS 18TH DAY OF JUNE 2008.

Matthew Denn

Insurance Commissioner

REPORT ON EXAMINATION
OF THE
BERKLEY INSURANCE COMPANY
AS OF
December 31, 2006

The above captioned Report was completed by examiners of the Delaware Insurance Department.

Consideration has duly been given to the comments, conclusions, and recommendations of the examiners regarding the status of the Company as reflected in the Report.

This Report is hereby accepted, adopted, and filed as an official record of this Department.

A handwritten signature in black ink, appearing to read "Matthew Denn", written in a cursive style.

MATTHEW DENN
INSURANCE COMMISSIONER

DATED this 18TH Day of JUNE 2008.

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SALUTATION

June 23, 2008

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Chairman, Financial Condition (E)
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Honorable Matthew P. Denn
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Secretary, Western Zone (IV) NAIC
Utah Department of Insurance
3110 State Office Building
Salt Lake City, Utah 84114-1201

Commissioners:

In compliance with instructions and pursuant to statutory provisions contained in Certificate of Authority No. 06-004, dated January 26, 2006, an examination has been made of the affairs, financial condition and management of the

BERKLEY INSURANCE COMPANY

hereinafter referred to as "Company" or "Berkley" and incorporated under the laws of the State of Delaware as a stock company with its home office located at 1209 Orange Street, Wilmington, Delaware, 19801. The examination was conducted at the main administrative office of the Company, located at 475 Steamboat Road, Greenwich, CT 06830.

The report of such examination is submitted herewith.

SCOPE OF EXAMINATION

The last examination was conducted as of December 31, 2003. This examination covers the period since that date through December 31, 2006, and consisted of a general review of the Company's business policies and practices, management, any corporate matters incident thereto, a verification and evaluation of assets and determination of liabilities. Transactions subsequent to the latter date were reviewed where deemed necessary.

The format of this report is designed to explain the procedures employed on examination and the text will explain changes wherever made. If necessary, comments and recommendations have been made in those areas in need of correction or improvement. In such cases, these matters were thoroughly discussed with responsible officials during the course of the examination.

The general procedures of the examination followed the rules established by the Committee on Financial Condition Examiners Handbook of the National Association of Insurance Commissioners ("NAIC") and generally accepted statutory insurance examination standards consistent with the Insurance Laws and Regulations of the State of Delaware. In accordance with the aforementioned Handbook, the consulting firm of INS Services, Inc. performed an information systems review.

In addition to items hereinafter incorporated as a part of the written report, the following areas were reviewed and included in the files of this examination.

Corporate Records
Fidelity Bonds and Other Insurance
Statutory Deposits
Employees' Welfare
All Asset and Liability Items not Mentioned
Subsequent Events

In addition to this examination of the Company, concurrent examinations were performed on the following subsidiaries and Delaware domestic companies:

Gemini Insurance Company
StarNet Insurance Company
Midwest Employers Casualty Company

Examination reports for the abovementioned companies were filed separately.

HISTORY

The Company was incorporated on December 18, 1975, under the laws of the State of Nebraska and commenced business on December 31, 1975, as Signet Reinsurance Company (Signet Re). The Company continued to conduct business as a Nebraska domiciled company until March 31, 1995, when it re-domesticated to the State of Delaware.

On July 1, 1993, W.R. Berkley Corporation (WRBC) and General Re Corporation (Gen Re) jointly formed a holding company, Signet Star Holdings, Inc. (Holdings). Holdings was formed to accommodate the 1993 merger of North Star Reinsurance Corporation (North Star) of Delaware (a Gen Re company) and Signet Re (a WRBC company). WRBC, a holding company that through its subsidiaries operates in all segments of the property and casualty insurance business, owned shares representing sixty percent (60%) of Holdings, while Gen Re owned the remaining forty percent (40%). North Star was then renamed Signet Star Reinsurance Company.

Effective December 18, 1995, Signet Star was renamed North Star and Signet Re was renamed Signet Star. On December 28, 1995, Gen Re reacquired North Star from Holdings, with North Star and Signet Star entering into an Assumption and Indemnity Agreement for all liabilities and obligations from any insurance or reinsurance written by North Star with an inception, renewal or premium anniversary date subsequent to December 31, 1992. Concurrent with these transactions, Gen Re sold its forty percent (40%) ownership in Holdings to WRBC.

The above ownership changes were a result of an Agreement and Plan of Restructuring approved by the Delaware Insurance Department.

On December 31, 2000, the name of the Company was changed to Berkley Insurance Company and in the year 2002 the Company moved from its former administrative office in Morristown, New Jersey to its present location in Greenwich, Connecticut.

CAPITALIZATION

Capital Stock

The Certificate of Incorporation provides that the Company is authorized to issue 500,000 shares of common capital stock having a par value of \$10 per share, of which 430,000 shares are issued and outstanding. The Company is also authorized to issue 100,000 shares of preferred stock having a par value of \$10 per share, of which 1,000 shares are issued and outstanding. Signet Star Holdings, Inc owns all shares of stock.

Gross Paid In and Contributed Surplus

The Company received capital contributions from its ultimate parent company, W. R. Berkley Corporation, as follows:

<u>Year</u>	<u>Amount</u>
2004	\$ 50,000,000
2005	<u>\$ 25,000,000</u>
Total	<u>\$ 75,000,000</u>

During the examination period of January 1, 2004 to December 31, 2006, the Company's gross paid in and contributed surplus increased from \$791,083,780 to \$866,083,780.

Dividends to Stockholder

An ordinary cash dividend of \$100,000,000, as authorized by the Company's Board of Directors and approved by the Delaware Insurance Department on November 29, 2006, was paid to Berkley's immediate parent, Signet Star Holdings, Inc., on December 18, 2006.

The following is a reconciliation of capital and surplus for the period under examination:

	<u>2004</u>	<u>2005</u>	<u>2006</u>
Surplus as regards policyholders, December 31, prior year	<u>\$1,174,543,257</u>	<u>\$1,511,628,362</u>	<u>\$1,785,230,929</u>
Net Income	154,796,633	180,705,089	442,620,297
Change in net unrealized capital gains (losses)	133,399,611	99,047,562	6,928,106
Change in net unrealized Foreign exchange gain (loss)	(1,971,216)	4,068,736	(1,551,450)
Change in net deferred income tax	24,222,367	33,937,560	23,711,538
Change in non-admitted assets	(21,241,341)	(27,915,146)	(8,367,982)
Change in provision for reinsurance	(2,120,949)	(41,241,234)	30,151,007
Surplus adjustments: Paid in	50,000,000	25,000,000	0
Dividends to stockholders			(100,000,000)
Change in surplus as regards policyholders, current year	<u>\$337,085,105</u>	<u>\$273,602,567</u>	<u>\$393,491,516</u>
Surplus as regards policyholders, current year	<u>\$1,511,628,362</u>	<u>\$1,785,230,929</u>	<u>\$2,178,722,445</u>

As a Subsequent event, it was noted that on May 3, 2007, the Company's Board of Directors declared an ordinary common stock dividend in the amount of \$300 million, payable to the parent on June 4, 2007.

MANAGEMENT AND CONTROL

Board of Directors

The amended and restated bylaws state that the affairs of the Company shall be managed by its Board of Directors consisting initially of seven directors, and thereafter consisting of such number as may be fixed from time to time by resolution of the Board of Directors. Directors are elected at the annual meeting of the stockholder and each Director serves for the term of one year

until the next annual election and until their successors are elected and qualified. Interim vacancies may be filled by a majority of the remaining directors, through less than a quorum, provided however that the stockholders removing any director may at the same meeting fill the vacancy caused by such removal, and provided further, that if the directors fail to fill any such vacancy, the stockholders may at any special meeting fill such vacancy. A majority of the Board of Directors at any time in office shall constitute a quorum.

The Board of Directors shall hold an annual meeting for the purpose of organization and the transaction of any business immediately after the annual meeting of the stockholders, provided a quorum is present. Special meetings of the Board of Directors may be called by the Chairman of the Board or by the President.

Members of the Board of Directors, duly elected in accordance with the Company's bylaws and serving as of December 31, 2006 were as follows:

Director

Primary Business Affiliation

Eugene George Ballard	Chief Financial Officer and Treasurer W.R. Berkley Corporation
William Robert Berkley	Chairman and Chief Executive Officer W.R. Berkley Corporation
William Robert Berkley, Jr.	Executive Vice President W.R. Berkley Corporation
Craig Nicholas Johnson	President and Chief Executive Officer Signet Star Re, LLC
Carol Josephine LaPunzina	General Counsel and Secretary Berkley Insurance Company
Ira Seth Lederman	General Counsel and Secretary W.R. Berkley Corporation
C. Fred Madsen	Senior Vice President W.R. Berkley Corporation

Committees of the Board of Directors

The following were members of the Business Ethics Committee that served as of December 31, 2006.

Larry Aaron Hansen, Chief Financial Officer
Carol Josephine LaPunzina, General Counsel and Secretary

Officers

The bylaws provide that the officers of the Company shall be a President, one or more Vice-Presidents, a Secretary, one or more Assistant Secretaries, a Treasurer, and one or more Assistant Treasurers, and the Board of Directors may appoint such other officers.

The Company's principal officers and their respective titles as of December 31, 2006 were as follows:

<u>Name</u>	<u>Title</u>
William Robert Berkley	President
Larry Aaron Hansen	Chief Financial Officer
Carol Josephine LaPunzina	Secretary
Eugene George Ballard	Senior Vice President
Roger Joseph Bassi	Executive Vice President
Robert Paul Cole	Senior Vice President
Ira Seth Lederman	Senior Vice President
Kevin John Shea	Senior Vice President
Craig Nicholas Johnson	Executive Vice President

Conflict of Interest Policy

The immediate parent company, W.R. Berkley Corporation, maintains a formal written Statement of Business Ethics for conflict of interest and business conduct procedures for its subsidiaries. This Statement requires Company personnel to submit certificate of compliance forms on at least an annual basis.

The Company implemented its procedures for the year 2005; however, the execution of certificate of compliance forms was not completed by five of its directors or officers in the year 2006.

Therefore,

It is recommended that the Company consistently comply with its Statement of Business Ethics procedures by verifying that its officers and or directors submit certificate of compliance or conflict of interest forms on at least an annual basis.

Timeliness and/or Lack of Board of Directors' Approvals of Transactions

During the period of January 1, 2004 to December 31, 2006, pertinent intercompany agreements and transactions were either not pre-approved, not authorized in a timely manner, or were not approved at all by the Board of Directors in 11 instances.

Therefore,

It is recommended that the Company's Board of Directors approve all inter-company agreements and material transactions as required.

HOLDING COMPANY SYSTEM AND AFFILIATED TRANSACTIONS

The Company is a member of an insurance holding company system and is a wholly owned subsidiary of Signet Star Holdings, Inc., a Delaware holding company that is a wholly owned subsidiary of the ultimate parent, W.R. Berkley Corporation (WRBC), domiciled in the State of Delaware.

WRBC, founded in 1967, is an insurance holding company that is among the largest commercial lines writers in the United States and operates in five segments of the property and casualty insurance business that include specialty insurance, regional property and casualty insurance, alternative markets, reinsurance and international. WRBC has offices throughout the United States, as well as producing business in Europe, South America and the Philippines.

As stated in its 2006 annual report, WRBC had assets of \$15.6 billion and stockholders' equity of \$3.3 billion.

The following organizational chart reflects the identities and interrelationships between the primary subsidiaries of the W. R. Berkley Corporation that are part of the holding company system as of December 31, 2006:

	Percentage owned by Berkley (1)
W. R. Berkley Corporation	
Berkley International, LLC (2)	100%
Berkley Surety Group, Inc.	100%
Carolina Casualty Insurance Company (FL)	100%
Clermont Specialty Managers, Ltd	100%
Greenwich Knight Insurance Company, Ltd.	100%
J/I Holding Corporation	100%
Admiral Insurance Company (DE)	100%
Admiral Indemnity Company (DE)	100%
Berkley London Holdings, Inc. (3)	100%
W.R. Berkley London Finance, Limited	80%
W.R. Berkley London Holdings, Limited	80%
W.R. Berkley Insurance (Europe), Limited	100%
Berkley Risk Administrators Company, LLC	100%
Clermont Insurance Company (IA)	100%
Nautilus Insurance Company (AZ)	100%
Great Divide Insurance Company (AZ)	100%
Key Risk Management Services, Inc.	100%
Monitor Liability Managers, Inc.	100%
Queen's Island Insurance Company, Ltd	100%
Signet Star Holdings, Inc.	100%
Berkley Insurance Company (DE)	100%
Berkley Regional Insurance Company (DE)	100%
Acadia Insurance Company (ME)	100%
Berkley Regional Specialty Insurance Company (DE)	100%
Continental Western Insurance Company (IA)	100%
Firemen's Insurance Company of Washington, D.C. (DE)	100%
Tri-State Insurance Company of Minnesota (MN)	100%
Union Insurance Company (IA)	100%
Union Standard Insurance Company (OK)	100%
Gemini Insurance Company (DE)	100%
Key Risk Insurance Company (NC)	100%
Midwest Employers Casualty Company (DE)	100%
Preferred Employers Insurance Company (CA)	100%
Riverport Insurance Company (CA)	100%
Signet Star Re, LLC	100%
StarNet Insurance Company (DE)	100%
Facultative ReSources, Inc.	100%

- 1 W.R. Berkley Corporation is the ultimate parent. The subsidiary of a direct parent is indicated by indentation, and its percentage ownership is as indicated in this column.
- 2 Owned by W.R. Berkley Corporation and its subsidiaries as follows: W.R. Berkley Corporation (2%), Admiral Insurance Company (35%), Berkley Insurance Company (35%), Berkley Regional Insurance Company (14%), and Nautilus Insurance Company (14%).
- 3 Owned by Admiral Insurance Company (66.67%) and Berkley Insurance Company (33.33%).

During the period under examination, Holding Company Registration Statements were filed with the Delaware Insurance Department that included intercompany agreements and transactions as required with the provisions of Regulation 1801 of 18 Del.C.

TERRITORY AND PLAN OF OPERATION

Territory

The Company is authorized to transact the business of insurance in thirty-six (36) states and the District of Columbia. In addition, the Company can write “Reinsurance only” in eight states and Puerto Rico and held the status of being an accredited reinsurer in the six states of Arizona, Maine, Missouri, New Hampshire, Virginia and Wyoming.

The principal office facilities of the Company are located in Greenwich, Connecticut. There is one reinsurance branch office located in Wanchai, Hong Kong that was formed in the year 2006, with an initial focus on property facultative reinsurance in the Asia-Pacific region.

Plan of Operation

The Berkley Insurance Group, led by the Berkley Insurance Company, writes standard and specialty commercial lines insurance and reinsurance coverages and ranks among the top professional reinsurers in the United States.

As an established reinsurer with both broker market and direct distribution capabilities, the group specializes in providing products and services to its clients that include property and casualty treaty reinsurance, facultative reinsurance, alternative risk products, and fidelity and surety reinsurance. Casualty lines of business comprise approximately 85% and property consists of 15% of the total reinsurance business.

The group maintains a corporate strategy that, through its operating units, operates independently based on customer orientation, product, class of risk and geographic territory. Each operating unit serves its specific market segment in an autonomous manner.

The group's reinsurance business is divided into different operating units that include the following affiliated companies:

Signet Star Re, LLC (Signet Star Re) underwrites and manages the Company's property and casualty treaty business. Signet Star Re specializes in providing specialty broker market reinsurance products and services, focusing on commercial casualty lines written on an excess of loss basis.

Facultative ReSources, Inc. acts as the group's facultative underwriting manager, and writes business primarily on an individual risk basis. Emphasis is geared toward excess of loss placement for general liability products, products liability and automobile coverage.

Berkley Underwriting Partners, LLC was formed to provide both reinsurance intermediaries and program administrators a single-source access to its primary insurance carriers and reinsurance support.

Fidelity and Surety Reinsurance Managers, LLC is the Company's fidelity and surety reinsurance underwriting manager that specializes in customized products for the standard market on a direct basis and through brokers.

B F Re Underwriters, LLC is a direct casualty reinsurance underwriting manager, providing automatic, semi-automatic and individual risk assumed reinsurance.

Berkley Risk Solutions, Inc. specializes in alternative risk transfer insurance and reinsurance transactions. This company underwrites traditional treaty reinsurance for companies that write medical malpractice.

Primary insurance is also provided through other subsidiaries of the Company, which are significantly reinsured by BIC. Direct premiums written by the Company were produced by a general agent and amounted to \$337,113 during the year 2006.

GROWTH OF THE COMPANY

The following information was extracted from the Company's filed Annual Statements and shows the growth of the Company since the last examination as of December 31, 2003.

<u>Year</u>	<u>Net Admitted Assets</u>	<u>Surplus as Regards Policyholders</u>	<u>Gross Premiums Written *</u>	<u>Net Premiums Written</u>	<u>Net Income</u>
2006	\$6,796,348,696	\$2,178,722,445	\$1,881,347,014	\$1,800,711,690	\$442,620,297
2005	5,870,233,360	1,785,230,929	1,826,506,667	1,739,246,508	180,705,089
2004	4,777,872,294	1,511,628,362	1,706,894,975	1,599,716,822	154,796,633
2003	3,783,165,805	1,174,543,257	1,600,801,012	1,396,715,282	74,853,587

* Direct premiums written and reinsurance assumed.

The increase in net income in 2006 was mainly due to the increase in net investment income, which was largely attributed to dividends received from affiliated common stocks.

REINSURANCE

For 2006, the Company reported the following distribution of premiums written:

Direct business	\$ 337,113
Reinsurance assumed (from affiliates)	979,979,950
Reinsurance assumed (from non-affiliates)	<u>901,029,951</u>
Gross premiums written	<u>1,881,347,014</u>
Reinsurance ceded (to affiliates)	(53)
Reinsurance ceded to (non-affiliates)	<u>80,635,377</u>
Total ceded	<u>80,635,324</u>
Net premiums written	<u>\$1,800,711,690</u>

A general outline of the significant assumed reinsurance agreements in effect at December 31, 2006 is as follows:

Assumed Reinsurance – Affiliates

The Company has assumed reinsurance agreements in effect at December 31, 2006, with five of its direct subsidiaries and ten of its indirect subsidiaries. Midwest Employers Casualty Company (MECC), Gemini Insurance Company (Gemini), and StarNet Insurance Company (StarNet) each a Delaware domiciled company and being concurrently examined; and Key Risk Insurance Company (Key Risk), a North Carolina domiciled company, and Preferred Employers Insurance Company, a California domiciled company, combined account for 91.38% of the Company's premiums written assumed from affiliates. See the comments below for further detail regarding the quota share agreements with these five affiliated companies. The balance of premiums written assumed from affiliates (8.62%) was derived from Berkley Insurance, Limited; Riverport Insurance Company; Carolina Casualty Insurance Company; Union Insurance Company; Berkley Regional Insurance Company; Continental Western Insurance Company; Great Divide Insurance Company; Nautilus Insurance Company; Union Standard Lloyds and Admiral Insurance Company. The most significant lines of business assumed from affiliates were workers' compensation (53.66%) and other liability – occurrence (24.47%).

Midwest Employers Casualty Company

Effective April 1, 2000, the Company entered into a quota share agreement with MECC under which the Company reinsured 100% of the net liabilities arising under the policies, contracts and binders of insurance or reinsurance in-force at the effective date or issued after that date and classified as property casualty business by MECC. Effective January 01, 2006, the agreement was amended retroactively reducing the reinsurance percentage to 90%. Premiums assumed from MECC for the 2006 calendar year totaled \$275,807,000.

Gemini Insurance Company

Effective January 1, 1998, the Company entered into a 90% quota share agreement with Gemini, under which the Company assumed 90% of the net liabilities arising under the policies, contracts and binders of insurance or reinsurance in force at the effective date or issued after that date and classified as property casualty insurance business by Gemini. Effective October 1, 2003 the agreement was amended retroactively, increasing the reinsurance percentage to 100%. Premiums assumed from Gemini for the calendar year 2006 totaled \$260,189,000.

Key Risk Insurance Company

Effective April 1, 2000, the Company entered into a 90% quota share agreement with Key Risk, under which the Company assumed 90% of the net liabilities arising under the policies, contracts and binders of insurance or reinsurance in-force at the effective date or issued after that date and classified as property casualty insurance business by Key Risk. Effective October 1, 2003 the agreement was amended retroactively, increasing the reinsurance percentage to 100%. Premiums assumed from Key Risk for the calendar year 2006 totaled \$124,900,000.

Preferred Employers Insurance Company

Effective April 1, 2000, the Company entered into a 90% quota share agreement with Preferred Employers Insurance Company (Preferred) under which the Company assumed 90% of the net liabilities arising under policies, contracts, and binders of insurance or reinsurance in-

force at the effective date or issued after that date and classified as property casualty insurance business by Preferred. Premiums assumed from Preferred for the calendar year 2006 totaled \$121,206,000.

StarNet Insurance Company

Effective September 1, 1998, the Company entered into a quota share agreement with StarNet under which the Company assumed 90% the net liabilities arising under the policies, contracts, and binders of insurance or reinsurance in-force at the effective date or issued after that date and classified as property casualty business by StarNet. Premiums assumed from StarNet for the calendar year 2006 totaled \$113,360,000.

Assumed Reinsurance – Non-Affiliates

The Company assumed business from a wide range of insurance companies. The Company focuses a significant portion of its marketing efforts on specialty casualty insurers. The underwriting department at the direction of top-level management generally affects marketing. The Company's marketing efforts emphasize its specialized divisional operations and capital base. New clients are evaluated for financial stability and performance results, and are re-evaluated at least once annually thereafter.

Business underwritten by the property and casualty treaty division pertained primarily to general commercial and personal lines with non-proportional assumed liability and other liability–occurrence accounting for 11.86% and 9.81% respectively of premiums assumed from non-affiliates in 2006.

The Facultative Division comprised of business underwritten through Facultative Resources, Inc., primarily utilizing reinsurance brokers, and BF RE Underwriters, primarily dealing directly with the underlying insurance company, accounted for 26.72% of premiums assumed from non-affiliates in 2006.

Ceded

The Company's net retention on any one risk is reduced to \$5,000,000 through its ceded reinsurance program. The Company ceded approximately 4.45% of the gross written premiums for the year ending December 31, 2006. Companies domiciled within the United States provide 53.91% of the coverage afforded by the Company's ceded reinsurance program.

INTERCOMPANY AGREEMENTS

The Company participated in the following inter-company management, service and limited partnership agreements that were in effect as of December 31, 2006:

Tax Allocation Agreement

Effective January 1, 1996 and amended December 31, 2000, the Company and W. R. Berkley Corporation (WRBC) entered into a tax allocation agreement. The Company is a member of an affiliated group of corporations of which WRBC, directly or indirectly, is the common parent that files consolidated federal income tax returns for the participating member companies.

The tax liability is allocated among affiliates in the ratio that each affiliate's separate return tax liability bears to the sum of the separate return tax liabilities of all affiliates that are members of the WRBC Group. Estimated payments are made by the respective affiliates to WRBC and if such member is entitled to a credit, WRBC will account for such amount in the same way as if a credit or a claim for a refund was made directly by an affiliate with the Internal Revenue Service.

Investment Agreements

The Company has two investment agreements described as follows:

Investment Advisory

Effective April 1, 1996, and amended December 31, 2000, the Company entered into an investment advisory agreement whereby Berkley Dean and Company, Inc. (Berkley Dean) will provide certain advisory and management services based upon criteria, standards and guidelines of the Company. The Company has ultimate and final authority over decisions and policies on purchases and sales of securities. Berkley Dean receives .25% of 1% of the first \$10,000,000 and .20% of 1% thereafter, of the net asset value of the portfolio at the end of each quarter when fee payments are due. Either party may terminate the agreement at any time with at least 90 days written notice prior to each anniversary of the agreement.

Asset Management

Effective January 1, 2005, the Company entered into an agreement whereby Steamboat Asset Management, LLC (SAM) acts as a manager for a specified portion of the Company's investment portfolio subject to the direction, control and supervision of the Company. SAM receives an annual administration fee paid by the Company monthly in arrears, equal to 1% per year of the Company's weighted average investment portfolio under the agreement for each calendar year, adjusted for deposits and withdrawals of funds, but not including or giving effect to gains or losses, dividends, distributions or other income from such portfolio during such year.

The agreement may be terminated at any time by either party with written notice and will automatically be cancelled in the event of its assignment by the manager without the written consent of the Company.

Cost Sharing Agreements

Effective July 1, 1997 and July 16, 1998, Berkley executed cost sharing agreements with Gemini and StarNet to provide certain property, equipment, facilities and personnel in performing certain underwriting, claims, accounting, legal and administrative functions and special services for its subsidiaries in their insurance and business operations.

Fees shall be charged on a cost basis and include directly allocable expenses, reasonably and equitably determined to be attributable to each subsidiary by Berkley plus a reasonable charge for direct overhead to be mutually agreed upon by the subsidiaries and Berkley from time to time; provided, however, that such charges shall be no greater than the subsidiaries would expend if providing such services for themselves.

Berkley shall submit within 30 days of the end of each calendar month a statement of the amount owed and Gemini and StarNet shall pay to Berkley within 15 days following receipt of such statement. Either party may cancel the agreement upon giving 60 days prior written notice.

Reinsurance Management Agreements

Berkley has seven reinsurance management service agreements with its managers for producing, underwriting, and servicing its facultative and treaty reinsurance business, including the handling and servicing of all claims and losses, and legal actions resulting or arising from such business.

Services performed by the managers are subject to the guidelines of the Company and include such functions as the following:

- Issue, cancel and amend reinsurance contracts
- Collect and pay premiums and return premiums on reinsurance
- Pay, reject, settle and adjust loss and loss adjustment expenses
- Pay all taxes and fees imposed by any government jurisdiction

Berkley compensates its managers for the actual cost of services provided to the Company by the manager, of which such costs include operating expenses incurred by the manager.

All agreements contain a provision that a statement of account shall be forwarded by the manager to the Company on a calendar quarterly basis in such form and detail as mutually agreed, but not later than 30 days after the close of each quarter. Settlement of balances by the

manager to the Company shall be no later than 30 days after the close of each quarter, and payment to the manager shall be upon receipt of the statement of account, unless the parties agree otherwise.

Duration and termination provisions are included in the agreements that remain in effect until cancelled by either party. The agreements are described as follows:

Facultative Resources, Inc.

Effective January 1, 1998 and last amended on June 1, 2002, Berkley entered into an agreement with Facultative Resources, Inc. (Fac Re) for managing its facultative reinsurance assumed business.

The manager is authorized to accept business by utilizing a gross line of \$7,500,000, any one certificate, each and every loss occurrence, any underwriting (calendar) year, but in no event will the manager bind the Company for a net line greater than \$4,500,000 any one certificate, each and every loss occurrence.

Fidelity & Surety Reinsurance Managers, LLC

Effective July 1, 2001, Berkley entered into an agreement whereby Fidelity & Surety Reinsurance Managers, LLC (Fidelity & Surety) is authorized to assume fidelity and surety treaty reinsurance in the name of the Company as issuing company as each assumption may require or dictate. The authority of the manager to act on behalf of the Company and perform services that are necessary and incidental are subject to the guidelines stated in the agreement.

The manager is authorized to utilize a gross line of \$5,000,000 for any one risk and in no event will the manager bind the Company for a net line greater than \$5,000,000 any one risk.

Signet Star RE, LLC

Effective July 1, 2001, Berkley entered into an agreement with Signet Star RE, LLC (Signet Star) to act as its manager with the authority to do all things necessary and incidental to the conduct of all kinds of treaty reinsurance assumed business within the terms and conditions of the agreement.

The manager is authorized to utilize a gross line of \$5,000,000 for any one risk and in no event will the manager bind the Company for a net line greater than \$5,000,000 any one risk.

Berkley Medical Excess Underwriters, LLC

Effective July 1, 2002, Berkley entered into an agreement with Berkley Medical Excess Underwriters, LLC (Berkley Medical) for managing its treaty quota share and excess of loss reinsurance for the following types of business: healthcare facility excess professional liability, healthcare facility excess general liability and follow-form excess liability.

The manager is authorized for any one risk, to accept a maximum liability limit of \$25,000,000 for each and every claim and in the aggregate. In no event will the manager bind the Company to a policy limit greater than the amount stated herein except to the extent that the manager has received express approval in advance from the Company.

B F Re Underwriters, LLC

Effective September 30, 2002, Berkley entered into an agreement with B F Re Underwriters, LLC (B F Re) to manage its facultative reinsurance, directly with insurers without the use of a reinsurance intermediary.

B F Re is empowered to assume facultative reinsurance in the name of the Company as issuing company as each individual assumption may require or dictate directly with the insurer.

The manager is authorized to utilize a gross line of \$7,500,000, any one certificate, each and every loss occurrence, any underwriting (calendar) year, but in no event, will the manager

bind the Company for a net line greater than \$4,500,000 any one certificate, each and every loss occurrence.

Berkley Accident and Health, LLC

Effective May 1, 2006, Berkley entered into an agreement with Berkley Accident and Health, LLC (BAH) to manage its accident and health assumed treaty reinsurance business.

The manager is authorized to utilize a gross line of \$10,000,000, for any one risk and in no event will the manager bind the Company for a net line greater than \$10,000,000 any one risk without first obtaining the prior written consent of the Company.

Berkley Aviation, LLC

Effective May 1, 2006, Berkley entered into an agreement with Berkley Aviation, LLC (BA) to manage its aviation assumed treaty reinsurance business.

The manager is authorized to utilize a gross line of \$10,000,000, for any one risk, but in no event, will the manager bind the Company for a net line greater than \$5,000,000 any one risk without first obtaining the prior written consent of the Company.

Underwriting Management Agreements

The Company has two underwriting management agreements and compensates its managers for the actual costs of services provided to the Company by the manager. Duration and termination provisions are included in the agreements that remain in effect until cancelled by either party. The agreements are described as follows:

Berkley Underwriting Partners, LLC

Effective July 1, 2001, Berkley entered into an agreement with Berkley Underwriting Partners, LLC (BUP) to act as a manager for coordinating and overseeing all activities relating to the production of insurance underwritten by general agencies that specialize in managing

program business. In addition, among other activities, BUP manages the placement of reinsurance through reinsurers in connection with the program business, can enter into agreements on the Company's behalf with Third Party Administrators (TPAs) for obtaining claims administration services, or can directly adjust or settle claims arising out of, or in connection with, policies pursuant to a program administration agreement entered into on behalf of Berkley.

Settlement of balances by the manager to the Company shall be no later than 30 days after the close of each quarter and settlement by the Company to the manager shall be upon receipt of the statement of account, unless the parties agree otherwise.

Berkley Risk Solutions, Inc.

Effective October 31, 2003, Berkley entered into an agreement with Berkley Risk Solutions, Inc. (Berkley Risk) to act as a manager for producing, underwriting, and servicing, on the Company's behalf, all kinds of insurance and reinsurance finite risk transactions with insurance companies and with self-insured entities, and reinsurance assumed professional liability business, including the handling and servicing of all claims and losses, and legal actions resulting or arising from such business.

Services performed by Berkley Risk are subject to the guidelines of the Company and include such functions as the following:

- Acceptance and declination of risks and programs
- Issuance, cancellation and amendment of insurance and/ or reinsurance contracts
- Collection of premiums and calculation of return premiums
- Rejection, adjustment and compromise of loss and loss expenses
- Recovery of losses and expenses from the Company's retrocessionaires, if any

The manager is authorized to place specific types of coverage as follows:

- ◇ Professional Liability Reinsurance Assumed: The manager can utilize a gross line of \$5,000,000, for any one risk and in no event, will the manager bind the Company for a net line greater than \$5,000,000 any one risk.
- ◇ Insurance and Reinsurance Finite Risk Business: No one transaction shall have a net financial risk of more than \$25,000,000, without the prior consent of the Company.

The manager shall forward a statement of account to the Company on a calendar quarterly basis in such form and detail as mutually agreed, however not later than 30 days after the close of each quarter. Settlement of balances by the manager to the Company shall be no later than thirty (30) days after the close of each quarter and settlement by the Company to the manager shall be upon receipt of the statement of account, unless the parties agree otherwise.

Limited Partnership Agreement

Effective February 1, 2003, the Company, along with Berkley Regional Insurance Company and Admiral Insurance Company, became limited partners in Berkley Capital Investors, L.P. (Berkley Capital), a Delaware limited partnership. The general partner is Berkley Capital, a Delaware limited liability company formed and controlled by W.R. Berkley Corporation.

The principal purpose of the partnership is to achieve long-term capital appreciation primarily through equity or equity-related investments in financial services and related companies. The general partner commits to contribute to the capital of the partnership, an amount equal to one-tenth of one percent (0.1%) of the partnership's total capital commitments. Each of the three limited partners contributed \$5,000,000 and has a 33.3% share of the partnership. The agreement provides that the general partner receive an annual management fee for the services it provides to the partnership equal to 1% of the partnership's total capital commitments. The term of the partnership, unless it is dissolved earlier as provided in the

agreement, shall continue for ten years after the initial closing date, but may be extended by the general partner for up to two additional one-year periods.

ACCOUNTS AND RECORDS

Information Systems Controls Evaluation

A high-level assessment of the internal control structure and process for the Company's accounting computer systems was discussed with management and reviewed after completion of questionnaires developed by the NAIC and the Delaware Department of Insurance. The discussions and review did not reveal any material deficiencies in the internal control structure of the Company.

Accounting System

All necessary accounting records of the Company are maintained on electronic data processing equipment. The Company's database was tested as part of Delaware examination procedures.

Independent Accountants

The Company's financial statements are audited each year by the firm of KPMG, LLP, ("KPMG") of New York, New York. KPMG issued an unqualified opinion of the audited statutory financial statements for all years under the examination review. The workpapers prepared by KPMG in connection with the annual audit were reviewed and relied upon to the extent possible.

FINANCIAL STATEMENTS

The following pages contain a statement of assets, liabilities, surplus and other funds as of December 31, 2006, as determined by this examination, along with supporting exhibits as detailed below:

Assets
Liabilities, Surplus and Other Funds
Statement of Income

Assets
As of December 31, 2006

	Ledger Assets	Non-Admitted Assets	Net Admitted Assets	Notes
Bonds	\$ 3,682,810,524		\$ 3,682,810,524	1
Stocks:				
Preferred	211,821,018		211,821,018	
Common	1,489,740,883		1,489,740,883	2
Mortgage loans on real estate: first liens	46,169,223		46,169,223	
Cash, cash equivalents, and short-term investments	454,378,936		454,378,936	
Other invested assets	261,916,721		261,916,721	
Aggregate write-ins for invested assets	861,386		861,386	
Investment income due and accrued	45,250,129		45,250,129	
Premiums in course of collections	308,045,829	-	308,045,829	
Accrued retrospective premiums	5,992,793		5,992,793	
Amounts recoverable from reinsurance	11,074,099		11,074,099	
Funds held by or deposited with reinsured co.'s	205,999,196	-	205,999,196	
Federal and foreign income tax recoverable	4,662,015	-	4,662,015	
Net deferred tax asset	166,685,794	100,592,809	66,092,985	
Electronic data processing equipment and software	152,983	28,090	124,893	
Furniture and equipment	1,468,250	1,468,250	0	
Receivable from parent, subsidiaries and affiliates	1,319,283	72,464	1,246,819	
Aggregate write-ins for other than invested assets:	-		-	
Goodwill	154,922	-	154,922	
Miscellaneous assets	34,261	27,936	6,325	
Prepaid expenses and deposits	224,774	224,774	0	
Total Assets	<u>\$ 6,898,763,019</u>	<u>\$ 102,414,323</u>	<u>\$ 6,796,348,696</u>	

**Liabilities, Surplus and Other Funds
As of December 31, 2006**

		Notes
Losses	\$ 3,275,514,256	3
Reinsurance payable on paid losses and LAE	25,335,711	
Loss adjustment expenses	339,729,740	3
Contingent commissions	8,737,878	
Other expenses	9,223,363	
Taxes, licenses and fees	2,008,127	
Unearned premiums	775,187,113	
Ceded reinsurance premiums payable	10,427,250	
Funds held under reinsurance treaties	12,888,189	
Amounts withheld by company for account of others	438,713	
Remittances and items not allocated	2,188,372	
Provision for reinsurance	34,126,993	
Net adjustments due to foreign exchange rates	1,790,823	
Payable to parent, subsidiaries and affiliates	18,568,795	
Payable for securities	12,827,951	
Liabilities for short sales at market value	76,629,165	
Deposit liability	11,188,246	
Derivative instruments	790,276	
Deferred rent credit	25,290	
Total Liabilities	<u>\$ 4,617,626,251</u>	
Common capital stock	\$ 4,300,000	
Preferred capital stock	10,000	
Gross paid-in and contributed surplus	866,083,780	
Unassigned funds (surplus)	<u>1,308,328,665</u>	
Surplus as regards policyholders	<u>\$ 2,178,722,445</u>	
Totals	<u><u>\$ 6,796,348,696</u></u>	

**Statement of Income
As of December 31, 2006**

UNDERWRITING INCOME

Premiums earned	\$ 1,740,163,769
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DEDUCTIONS

Losses incurred	\$ 1,032,284,799
Loss expenses incurred	156,699,194
Other underwriting expenses incurred	451,941,288
Miscellaneous other (income) / loss	-
Total underwriting deductions	\$1,640,925,281
Net underwriting gain or (loss)	\$99,238,488

INVESTMENT INCOME

Net investment income earned	\$ 432,490,041
Net realized capital gains or (losses)	12,696,522
Net investment gain or (loss)	\$ 445,186,563

OTHER INCOME

Miscellaneous income	\$ 9,919
Loss on sales of fixed assets	(2,582)
Loss on foreign exchange	(1,185,038)
Total other income	\$ (1,177,701)
Net income before dividends to policyholders and before federal income taxes	\$ 543,247,350
Dividends to policyholders	0
Net income after dividends to policyholder but before federal income taxes	\$ 543,247,350
Federal and foreign income taxes incurred	100,627,053
Net income	\$ 442,620,297

CAPITAL AND SURPLUS ACCOUNT

Surplus as regards policyholders, December 31, 2005	\$ 1,785,230,929
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Net income	\$ 442,620,297
Net unrealized capital gains or (losses)	6,928,106
Change in net unrealized foreign exchange capital gain	(1,551,450)
Change in net deferred income tax	23,711,538
Change in non-admitted assets	(8,367,982)
Change in provision for reinsurance	30,151,007
Dividends to stockholders	(100,000,000)
Change in surplus as regards policyholders for the year	\$ 393,491,516

Surplus as regards policyholder, December 31, 2006	\$ 2,178,722,445
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FINANCIAL EXAMINATION ADJUSTMENTS

No financial adjustments were made as a result of this examination.

NOTES TO FINANCIAL STATEMENTS

Note 1 - Bonds

\$3,682,810,524

Bonds, comprising of 54.19% of total admitted assets, were determined to be the same amount as reported by the Company in its Annual Statement. In addition, 99.5% of the bonds were rated Class 2 or higher by the NAIC Securities Valuations Office.

Note 2 – Common stocks

\$1,489,740,883

Common stocks, comprising of 21.92% of total admitted assets, were determined to be the same amount as reported by the Company in its Annual Statement.

The Company's investments in its subsidiaries, amounting to \$1.207 billion or 81.03% of its common stock investments, were valued according to the book value reported in each insurance subsidiaries' 2006 Annual Statement, and audited financial statements for the non-insurance subsidiaries.

Note 3 – Losses

\$3,275,514,256

Loss Adjustment Expenses

\$ 339,729,740

INS Consultants, Inc. (INS) was retained by the Delaware Insurance Department to conduct a review of the Company's reserve methodologies and adequacy. Based on their review, the Company's reported total loss and loss adjustment expense reserves at December 31, 2006 of \$3,615,243,996 were properly stated. INS's analysis is net of reinsurance and does not address the collectability of reinsurance recoverables.

The underlying data was tested through a review of open and paid claim files and actual payments made, with no exceptions noted. The aggregated actuarial data provided by the Company, was verified and balanced to Schedule P of the Company's filed Annual Statement.

COMPLIANCE WITH PRIOR REPORT RECOMMENDATIONS

The Company has fully complied with all prior examination report recommendations.

SUMMARY OF RECOMMENDATIONS

It is recommended that the Company consistently comply with its Policy Statement on Conflict of Interest procedures by verifying that its officers and directors review and execute the questionnaires on an annual basis. (See Management and Control: Conflict of Interest Policy, page 8)

It is recommended that the Company's Board of Directors approve all intercompany agreements and material transactions as required. (See Management and Control: Lack of Board of Directors Approvals of Transactions, page 8)

CONCLUSION

The following schedule shows the results of this and the prior examination with changes during the three-year period:

<u>Description</u>	<u>December 31 2003.</u>	<u>December 31, 2006</u>	<u>Difference</u>
Assets	\$3,783,165,805	\$6,796,348,696	\$3,013,182,891
Liabilities	2,608,622,548	4,617,626,251	2,009,003,703
Capital and Surplus	1,174,543,257	2,178,722,445	1,004,179,188

The assistance of Delaware's consulting firms, INS Consultants, Inc., and INS Services, Inc. is acknowledged.

Respectfully submitted,



Douglas E. Bey, CFE
Examiner-In-Charge
State of Delaware
Northeastern Zone, NAIC